

WILLIAM A. MUNDELL
CHAIRMAN

JIM IRVIN
COMMISSIONER

MARC SPITZER
COMMISSIONER

ORIGINAL



ARIZONA CORPORATION COMMISSION



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OPEN MEETING ITEM

MEMORANDUM

TO: Chairman William A. Mundell
Commissioner Jim Irvin
Commissioner Marc Spitzer

Arizona Corporation Commission

DOCKETED

AUG 15 2001

FROM: Mark Sendrow *MS*
Director of Securities

DOCKETED BY	<i>st</i>
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DATE: August 14, 2001

RE: Proposed Rules A.A.C. Title 14, Chapter 4, Article 3
Docket No. RS-00000A-00-0752

cc: Brian C. McNeil, Executive Secretary

AZ CORP COMMISSION
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The Securities Division (the "Division") is seeking permission from the Commissioners to publish a Notice of Proposed Rulemaking concerning A.A.C. R14-4-301 through R14-4-308 ("Article 3"). Article 3 contains the rules that govern the administrative process under the Arizona Securities Act and the Arizona Investment Management Act.

The Division recommends several changes to Article 3 to reflect recent statutory changes and to facilitate the administrative process. A redlined version and a proposed draft of Article 3 are attached for your review. Included in the proposed changes are the following:

- The deletion of several definitions that have been added to the Securities Act or are unnecessary.
- The deletion of the confidentiality rule because the statutes contain confidentiality provisions at A.R.S. § 44-2042 and § 44-3300.
- An update of the rule governing service of process, including the addition of a method to serve by publication.
- An update of the rule regarding a notice of opportunity and hearing time frames to reflect statutory changes.
- The addition of a requirement that an answer be filed in connection with a request for a hearing.

- A revision of the time frame for a temporary cease-and-desist order from 120 to 180 days.
- A revision of the time frame within which a hearing shall be set in connection with a temporary cease-and-desist order.
- The addition of standards within which the Commission may exercise its discretion with respect to the order of rescission and restitution to conform to Administrative Procedures Act requirements.

The Division has solicited the informal advice and comments of the office of the attorney general, the securities section of the Arizona State Bar, the Hearing Division's staff, and the Securities Division's staff regarding the changes to the rules.

The Division recommends that the Commission send to the secretary of state's office a Notice of Proposed Rulemaking and obtain public comment regarding Article 3.

Originator: Cheryl T. Farson
Asst. AG Assigned: Moira McCarthy

ARTICLE 3. PROVISIONS RELATING TO ENFORCEMENT RULES OF PROCEDURE
FOR INVESTIGATIONS, EXAMINATIONS, AND ADMINISTRATIVE
PROCEEDINGS

R14-4-301. Scope of Article

This Article applies to investigations, ~~and examinations, and administrative proceedings~~ conducted pursuant to the provisions of under the Securities Act and the IM Act, ~~and to any orders issued under such acts.~~ When not in conflict with this Article, the applicable provisions of A.A.C. R14-3-101 through R14-3-113 ~~also shall apply.~~

R14-4-302. Definitions

The definitions set forth in A.R.S. §§ 44-1801 and 44-3101 and The ~~the~~ following definitions shall apply to this Article 3, ~~unless the context otherwise requires:~~

1. ~~“Attorney General” means the duly qualified and acting Attorney General of Arizona or the Attorney General’s duly appointed assistant.~~
2. ~~“Division” means the Securities Division of the Arizona Corporation Commission.~~
3. ~~“Formal interview” means the examination under oath of an individual compelled or requested to testify as part of an investigation or examination.~~
4. ~~“Hague Convention” means the Hague Convention on the Service Abroad of Judicial and Extrajudicial Documents, November 15, 1965, 20 U.S. Treaties and Other International Agreements 361, which is incorporated by reference, does not contain any later amendments or editions, and is on file in the Office of the Secretary of State. Copies of the Hague Convention are available from the Securities Division of the Arizona Corporation Commission and from the Treaty Affairs Section, Office of the Legal Adviser, Department of State, Washington, D.C. 20520.~~
52. “IM Act” means the Arizona Investment Management Act, A.R.S. § 44-3101 et seq.
63. “Respondent” means any person ~~who has been captioned in or served a notice or order of the Commission against whom the Division files a complaint, notice, petition, or order.~~
74. “Securities Act” means the Securities Act of Arizona, A.R.S. § 44-1801 et seq.
8. ~~“Unincorporated organization” includes a limited liability company for purposes of the definition of “person”, as defined in A.R.S. § 44-1801 (13).~~

R14-4-303. Confidentiality

~~All information or documents obtained by officers, employees, or agents of the Commission, including, but not limited to, the shorthand reporter or stenographer transcribing the reporter’s~~

notes, in the course of any examination or investigation shall, unless made a matter of public record, be deemed confidential. Officers, employees, and agents are prohibited from making such confidential information available to anyone other than a member, officer or employee of the Commission, agents designated by the Commission or Director, the Attorney General, and law enforcement or regulatory officials, except in accordance with any rule of the Commission or unless the Commission or the Director authorizes the disclosure of such information or documents as not contrary to the public interest.

~~R14-4-304~~R14-4-303. Methods of Service of Subpoenas, Notices, Orders, and Other Administrative Documents

- A. Documents required to be served in an administrative proceeding. All pleadings, motions, appearances, Subpoenas, notices, and orders, and similar papers filed in the record shall be served upon the Division and each respondent to the administrative proceeding by the filing party. issued pursuant to the Securities Act or the IM Act, and any other documents filed in an administrative proceeding under the Securities Act or the IM Act, may be served by a sheriff, by the sheriff's deputy, by an employee of the Commission, or by any other person who is not less than 18 years of age, and who is authorized by the Division or the Commission to serve the Commission's subpoena, notice, order, or other documents filed in the administrative proceeding.
- B. Service on the Division. Service upon the Division may be made by mailing a copy to the Division addressed to the attorney of record for the Division or by delivering a copy to the Division addressed to the attorney of record for the Division.
- ~~DC.~~ Service on a respondent represented by an attorney. Whenever service is required or permitted to be made upon a respondent has been served with a notice or a temporary cease and desist order and the respondent is represented by an attorney, in the administrative proceeding relating to the notice or the temporary cease and desist order, the service upon the respondent shall be made by making service upon the attorney. Service upon the attorney shall be deemed complete when a copy of any amended notice, order, or other documents filed in the administrative proceeding, addressed to the last known business address of the attorney, is deposited in the United States mail with 1st class postage prepaid by mailing a copy to the last known business or mailing address of the attorney or by any method authorized under subsections (D) and (E).
- D. Service upon individuals. Subpoenas, notices, orders, and other documents filed in an administrative proceeding may be served upon a natural person including, but not limited to, a dealer, salesman, investment adviser, or investment adviser representative, as followsService upon an individual may be made by any of the following:
1. By personal service.

2. By leaving a copy at the ~~person's individual's~~ dwelling house, or usual place of abode, with an ~~person individual~~ of suitable age and discretion, ~~but not less than 16 years of age, then~~ residing therein.
3. By leaving a copy at the ~~person's individual's~~ usual place of business or employment with an employee, express or implied agent, supervisor, owner, officer, partner, or other similar ~~person individual~~ of suitable age and discretion, ~~but not less than 16 years of age.~~
4. By leaving a copy with an agent authorized by express or implied appointment or by law to receive service of process for the ~~person individual to whom the subpoena, notice, or order is addressed upon whom service is being made.~~
5. By mailing a copy ~~of the subpoena, notice, or order in an envelope addressed to the last known dwelling, house or usual place of abode, or last known business address, or mailing address.~~ Subpoenas, notices, and temporary cease-and-desist orders served by mail shall be sent, postage prepaid return receipt requested, by certified mail, express mail, registered mail, or commercial courier or delivery service. ~~with return receipt requested.~~ The signed return receipt shall constitute proof of service, ~~of subpoenas, notices, and temporary cease and desist orders but shall not be the exclusive method of proving service.~~ ~~Service of all other orders or other documents filed in the administrative proceeding shall be deemed complete when a copy in an envelope, addressed to the last known dwelling house or usual place of abode or last known business address, is deposited in the United States mail with 1st class postage prepaid.~~

CE. Service upon a corporation or other entity. ~~A subpoena, notice, order, or other document filed in an administrative proceeding may be served~~ Service upon a corporation, partnership, trust, limited liability company, association, sole proprietorship, or any other business entity, including, but not limited to, a dealer or an investment adviser, as follows may be made by any of the following:

1. By leaving a copy with an employee, of suitable age and discretion, ~~but not less than 16 years of age,~~ at any place of business of the corporation, partnership, trust, limited liability company, association, sole proprietorship, or other business entity;
2. By leaving a copy with any officer or director of a corporation, managing or general partner of a partnership, trustee of a trust, member of a member-managed limited liability company or manager of a manager-managed limited liability company, or any ~~authorized representative of an association or other business entity;~~
3. By leaving a copy with any agent authorized by express or implied appointment or by law to receive service of process for the entity ~~to whom the subpoena, notice, or order is addressed; or upon whom service is being made.~~
4. By mailing a copy to the last known business or mailing address. Subpoenas, notices, and temporary cease-and-desist orders served by mail shall be sent, return receipt

~~requested, postage prepaid, by certified mail, express mail, registered mail, or commercial courier or delivery service with return receipt requested.~~ The signed return receipt shall constitute proof of service, ~~of subpoenas, notices, and temporary cease-and-desist orders~~ but shall not be the exclusive method of proving service. ~~Service of all other orders or other documents filed in the administrative proceeding shall be deemed complete when a copy in an envelope, addressed to the last known business address, is deposited in the United States mail with 1st class postage prepaid.~~

~~EF.~~ Service in a foreign country. ~~Unless otherwise provided by law, service may be effected in a foreign country:~~

- ~~1. By any internationally agreed means reasonably calculated to give notice, such as those means authorized by the Hague Convention, provided, however, that if service is not effected within 6 months from the date on which the assistance of the government of the foreign country was requested pursuant to the applicable treaty or convention, service may be effected as directed by the Commission; or~~
- ~~2. If internationally agreed means of service are unavailable, provided that service is reasonably calculated to give notice:~~ When serving a subpoena, notice, or temporary cease-and-desist order in a foreign country, service shall be by any internationally agreed means. If service is not accomplished within 120 calendar days from the date service was undertaken under the internationally agreed means or if no internationally agreed means of service has been established or the international agreement does not prohibit the use of other means of service, then service of any document may be made by any of the following:
 - ~~a1.~~ In the manner prescribed by the law of the foreign country for service in that country in an action in any of its courts of general jurisdiction; ~~or~~
 - ~~b2.~~ As directed by the foreign authority in response to a letter rogatory or letter of request; ~~or~~
 - ~~c3.~~ By any of the following if not ~~Unless prohibited by the law of the foreign country;~~ by
 - ~~i. Delivery of copies of the subpoena, notice, order, or other document filed in the administrative proceeding to the party to be served personally; or~~
 - ~~ii a. Any form of mail requiring a signed receipt, to be addressed and dispatched by the Commission to the party to be served; or~~ method of service authorized by subsections (D) or (E).
 - ~~iii b. Diplomatic or consular officers when authorized by the United States Department of State; or~~

iiic. If there is no lawful means by which service can be effected in the foreign country, such means as the Commission shall direct. By any other lawful method that is reasonably calculated to give notice as directed by the Commission.

G. When service is complete. Service by mail is complete upon mailing. All other service is complete upon delivery.

H. Service by Publication.

1. The Division may serve a person by publication under either of the following circumstances:

a. The Division does not know the current address or residence of a person to be served.

b. The person has avoided service and service by publication is the best means practicable under the circumstances for providing notice of the administrative proceedings.

2. Service by publication shall be made as follows:

a. The Division shall publish a statement regarding the administrative proceedings at least once a week for 4 successive weeks in a newspaper published in Maricopa county. If the person's last known residence or place of business was in a different county in Arizona or another state, the Division shall also simultaneously publish the statement in a newspaper published in the different county. If no newspaper is published in the person's last known county of residence or place of business, then the publications shall be made in a newspaper published in an adjoining county.

b. The published statement shall include the following information:

i. The name of the person.

ii. The statutes or rules that the Division alleges the person has violated or is violating.

iii. The location and the manner in which the person may obtain a copy of the notice or temporary cease-and-desist order being served.

iv. The requirement and deadline for filing a request for hearing and the ability of the Commission to enter a default order if the person fails to timely request a hearing.

3. The service shall be complete 30 days after the first publication.

~~R14-4-305~~R14-4-304. Rights of Witnesses; Formal Interview; Procedures

- A. Any person required or requested to appear as a witness at a formal interview may be ~~accompanied, represented, and advised~~ by a lawyer. The lawyer's role during the formal interview shall be limited to the following activities:
1. Giving legal advice to the witness before, during, and after the formal interview~~;~~.
 2. Questioning the witness briefly at the conclusion of the formal interview for the purpose of clarifying any testimony the witness has given~~;~~ ~~and~~.
 3. Making summary notes during the formal interview solely for the use of the witness and the lawyer.
- B. Notwithstanding subsection (A), the following lawyers may not represent witnesses at a formal interview:
1. Any lawyer who has represented another witness who has testified at a formal interview in the examination or investigation~~;~~.
 2. Any lawyer who has represented another person who is a subject of the examination or investigation~~;~~.
 3. Any lawyer who may be a material witness in the examination or investigation~~;~~.
 4. Any lawyer who is a subject of the examination or investigation.
- C. The Director may permit a lawyer to represent a witness in those situations described in subsections (B)(1) through (B)(4) upon a showing that such representation should be permitted in the interest of justice and will not obstruct the examination or investigation. If a lawyer is not permitted to represent a witness under subsection (B), that lawyer's partners or associates of the lawyer's law firm are also precluded from representing the witness.
- D. All formal interviews may be recorded by the Division either mechanically or by a shorthand reporter employed by the Division. No other recording of the formal interview will be permitted, except summary note taking by the attendees.
- E. ~~Unless permitted in the discretion of the Division, no witness or lawyer accompanying such witness shall be permitted to be present during the formal interview of any other witness testifying in a nonpublic examination or investigation. No person not employed by the Commission or the Attorney General shall be present during a formal interview except that the Division may authorize members of law enforcement or other state, federal, or self-regulatory agencies to be present during such formal interview. In addition to the persons identified in subsections (A), (C), and (D), the following individuals may attend a formal interview:~~

1. Individuals employed by the Commission or the office of the Attorney General.
 2. Members of law enforcement or other state, federal, or self-regulatory agencies authorized by the Division.
 3. Translators authorized by the Division.
- F. The Division may exclude from a formal interview any person previously permitted to attend the formal interview, including a lawyer, whose conduct is dilatory, obstructionist, or contumacious. In addition, the members of the staff of the Division conducting the formal interview may report the conduct to the Director for appropriate action. The Director may thereupon take such further action as circumstances may warrant, including, but not limited to, exclusion from further participation in the examination or investigation.
- G. A person who has submitted documentary evidence or testimony in connection with a formal interview shall be entitled, upon written request, and upon proper identification, to inspect the witness' own testimony on a date to be set by the Director. The Director may delay the inspection of the record until the conclusion of the examination or investigation if, ~~in the Director's discretion,~~ the Director determines that earlier inspection may obstruct or delay the examination or investigation.
- H. In connection with an examination or investigation, the Director may delegate authority to members of the staff to administer oaths and affirmations, sign subpoenas, take evidence, and receive books, papers, contracts, agreements or other documents, records, or information, whether filed or kept in original or copied form or electronically stored or recorded.
- I. During a formal interview, a witness shall not knowingly make any untrue statements of material fact or omit to state any material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading.

R14-4-305. Answers

- A. Within 30 calendar days after the date of service of a notice of an opportunity for a hearing, a respondent who has requested a hearing shall file in the record and serve on the Division an answer to the notice.
- B. The answer shall contain the following:
1. An admission or denial of each allegation in the notice.
 2. The original signature of the respondent or the respondent's attorney.
- C. A statement of a lack of sufficient knowledge or information shall be considered a denial of an allegation.

- D. An allegation not denied shall be considered admitted.
- E. When a respondent intends in good faith to deny only a part or a qualification of an allegation, the respondent shall specify that part or qualification of the allegation and shall admit the remainder.
- F. The respondent waives any affirmative defense not raised in the answer.
- G. The officer presiding over the hearing may grant relief from the requirements of this Section for good cause shown.

R14-4-306. Notice of an Opportunity for a Hearing and Notice of a Hearing

- A. The Commission may issue a notice of an opportunity for a hearing or a notice of a hearing to determine whether to issue a cease-and-desist order, order of rescission, restitution, or penalties, or other order authorized pursuant to the provisions of the Securities Act or the IM Act.
- B. A notice of an opportunity for a hearing and a notice of a hearing shall be served by any method permitted in ~~R14-4-304~~R14-4-303. A notice of an opportunity for a hearing shall set forth that the respondent will be afforded a hearing upon request to docket control of the Commission if the request is made in writing within 10 days after receipt of the notice by the respondent.
- C. When a respondent requests a hearing pursuant to a notice of an opportunity for a hearing in accordance with the provisions of this rule, the Commission shall set a date, time, and place for the hearing and shall forthwith notify the respondent. The date set for the hearing shall be within ~~30~~60 days, but not earlier than ~~15~~20 days, after the written request for hearing has been made, unless otherwise provided by law, stipulated by the parties, or ordered by the Commission.

R14-4-307. Temporary Cease-and-desist Orders

- A. When the ~~Division-Commission~~ determines that the ~~public interest will be harmed by delay in issuing an order to cease and desist~~public welfare requires immediate action, the ~~Division-Commission may, with the consent of the Commission,~~ issue a temporary cease-and-desist order, which will be in effect for ~~120-180~~ days or until vacated, modified, or made permanent in accordance with this rule, whichever comes 1st. The Commission may delegate this authority to the Director.
- B. Temporary cease-and-desist orders shall be served pursuant to the provisions of ~~R14-4-304~~R14-4-303.
- C. The temporary cease-and-desist order shall set forth that the respondent will be afforded a hearing upon request to docket control of the Commission if the request is filed in writing within 20 days of service of the temporary cease-and-desist order. If a request for a hearing

is not filed within 20 days, the Commission may, by written findings of fact and conclusions of law, vacate, modify, or make permanent the temporary cease-and-desist order.

- D. When a respondent requests a hearing in accordance with the provisions of this rule, the Commission shall set a date, time, and place for the hearing and shall forthwith notify the respondent. The date set for the hearing shall be within ~~15~~30 days, but not earlier than ~~5~~10 days, after the written request for hearing has been filed, unless otherwise provided by law, stipulated by the parties, or ordered by the Commission. The Commission may, after such hearing, by written findings of fact and conclusions of law, vacate, modify, or make permanent the temporary cease-and-desist order.
- E. The effective date stated in subsection (A) shall be tolled from the date a hearing is requested until a decision is entered, unless otherwise ordered by the Commission.

R14-4-308. Rescission and Restitution

- A. ~~Where there has been a violation of~~When a person or persons have violated the Securities Act or the IM Act, or any rule or order of the Commission, the Commission may require the person or persons responsible for the violation may be required, pursuant to the Securities Act or the IM Act, to make rescission and/or restitution as provided herein.
- B. ~~Where~~If a rescission offer is ordered by the Commission,
1. The respondent shall submit The the following materials to the Division and, upon approval must be filed with and receive prior approval from the Director, before distribution distribute the materials to the purchasers:
 - a. A written offer to repurchase stating in reasonable detail the facts out of which liability arose and, in the event of a violation of A.R.S. §§ 44-1991, 44-1992, or 44-3241, the correct, true, or omitted facts.
 - b.—An offer to repurchase the security shall include an offer of:
 - i. Cash ~~(or, if the Commission determines it is in the public interest, other property)~~equal to the fair market value of the consideration paid, (determined as of the date such payment was originally paid by the buyer)~~or such lesser amount as shall be ordered by the Commission (if it determines that it is in the public interest to order such lesser amount);~~ together with
 - ii. ~~Such amount or rate of interest as shall be ordered by the Commission~~ Interest at a rate pursuant to A.R.S. § 44-1201 for the period from the date of the purchase payment to the date of repayment; less

- iii. The amount of any principal, interest, or other distributions received on the security for the period from the date of purchase payment to the date of repayment.
 - eb. The offer to repurchase shall be accompanied by a prospectus and other documents making full written disclosure about the financial and business condition of the issuer and the financial and business risks associated with the retention of the securities ~~and contain any such further information as the Commission may require.~~
 - ec. The offer to repurchase shall state that such offer may be accepted by the purchaser at any time within a specified period of not less than 30 days after the date of receipt thereof ~~unless a shorter period of time is ordered by the Commission.~~
2. The offer and any other materials required to be presented to the purchaser shall be made within a period specified by the Commission.
 3. Financial statements prepared in accordance with R14-4-120, A.R.S. § 44-3159, or other ~~appropriate documentation~~ documents relating to the business of the respondent as requested by the Director or the Commission, shall be provided to the Director. If a respondent demonstrates that it cannot obtain audited financial statements without unreasonable effort or expense, then the respondent shall provide to the Director a notarized statement of financial condition. The financial statements or documentation shall demonstrate that the person or persons funding the rescission offer has or have adequate funds to pay the amount ordered pursuant to subsection (B)(1)(b)(a) to all purchasers of the securities who are eligible to accept the rescission offer. The seller, issuer, or other 3rd party may fund ~~funding of the rescission offer may be provided by the seller, issuer, or other 3rd party.~~
 4. The Commission may order that funds be deposited in escrow ~~as the Commission deems necessary.~~
 5. When the rescission offer has been completed and the appropriate funds paid, the person funding the rescission offer ~~must~~ shall verify to the Director that the rescission offer was made in accordance with this rule. The verification may be performed by an independent 3rd party, such as an accountant or escrow agent, ~~and by providing the pertinent records documenting the rescission offer to the Director.~~ All of the ~~The~~ following information must be included ~~unless otherwise ordered by the Commission:~~
 - a. Names, addresses, and telephone numbers of all securities holders of the issuer who had a right to receive the rescission offer, the amount and purchase dates of securities held by such securities holders, and the amount of principal, interest, or other distributions on all securities held by such securities holders;

- b. Names, addresses, and telephone numbers of all securities holders of the issuer who did not receive the rescission offer and the reason why they did not receive the rescission offer, the amount and purchase dates of securities held by such securities holders, and the amount of principal, interest, or other distributions on all securities held by such securities holders;
 - c. Verification of receipt of the rescission offer by all securities holders who had a right to and did receive the rescission offer;
 - d. A list of securities holders who accepted the rescission offer and those who did not accept;
 - e. Verification of payment of principal and interest ordered to be paid to all such securities holders who accepted the rescission offer.
6. Based on the circumstances of the respondent and the purchasers, if necessary or appropriate to the public interest and consistent with the protection of the investors, the Commission may prescribe by order alternative rescission offer terms, including:
- i. The offer of other identified assets in lieu of cash if the respondent lacks sufficient cash to offer the amount required under subsection (B)(1)(a).
 - ii. The offer of a specified lesser amount than the amount required under subsection (B)(1)(a) if the respondent lacks sufficient assets to offer the amount required under subsection (B)(1)(a).
 - iii. The inclusion in the repurchase offer of information material to an understanding of the issuer, in addition to that required by subsection (B)(1)(b), if such information would be required if the securities were being registered.
 - iv. A shorter period of time during which the offer to repurchase may be accepted.
 - v. Waiver of specified information required by subsection (B)(5) if the Commission determines that producing such information will be unduly burdensome.

C. ~~Where~~If restitution is ordered by the Commission,

- 1. The amount payable as damages to each purchaser shall include: ~~the amount computed under subsection (B)(1)(b) less the amount of any sale proceeds received on disposal of the security if it was sold at any time by the purchaser.~~
 - a. Cash equal to the fair market value of the consideration paid, determined as of the date such payment was originally paid by the buyer; together with
 - b. Interest at a rate pursuant to A.R.S. § 44-1201 for the period from the date of the purchase payment to the date of repayment; less

- c. The amount of any principal, interest, or other distributions received on the security for the period from the date of purchase payment to the date of repayment.
2. Financial statements prepared in accordance with R14-4-120, A.R.S. § 44-3159, or other ~~appropriate documentation documents~~ relating to the business of the respondent as requested by the Director or the Commission, shall be provided to the Director. If a respondent demonstrates that it cannot obtain audited financial statements without unreasonable effort or expense, then the respondent shall provide to the Director a notarized statement of financial condition. The financial statements or documentation shall demonstrate that the person paying restitution has adequate funds to pay all purchasers the amount computed in subsection (C)(1).
3. The Commission may order that funds be deposited in escrow ~~as the Commission deems necessary.~~
4. The Commission may order the respondent to provide the following information to the Division:
 - a. Names, addresses, and telephone numbers of all securities purchasers who had a right to receive restitution under the Commission's order; amount and purchase dates of securities purchased by such purchasers; fair market value of any non-cash consideration received by respondent from each purchaser of such securities; and any payment of principal, interest, or any other distribution on such security.
 - b. Verification of payment of principal and interest ordered to be paid to all such purchasers.
5. Based on the circumstances of the respondent and the purchasers, if necessary or appropriate to the public interest and consistent with the protection of the investors, the Commission may prescribe by order alternative restitution terms, including:
 - i. The payment of other identified assets in lieu of cash if the respondent lacks sufficient cash to pay the amount required under subsection (C)(1).
 - ii. The payment of a specified lesser amount than required under subsection (C)(1) if the respondent lacks sufficient assets to meet the subsection (C)(1) requirement.

ARTICLE 3. RULES OF PROCEDURE FOR INVESTIGATIONS, EXAMINATIONS, AND ADMINISTRATIVE PROCEEDINGS

R14-4-301. Scope of Article

This Article applies to investigations, examinations, and administrative proceedings under the Securities Act and the IM Act. When not in conflict with this Article, the provisions of A.A.C. R14-3-101 through R14-3-113 apply.

R14-4-302. Definitions

The definitions set forth in A.R.S. §§ 44-1801 and 44-3101 and the following definitions apply to this Article 3.

1. "Formal interview" means the examination under oath of an individual compelled or requested to testify as part of an investigation or examination.
2. "IM Act" means the Arizona Investment Management Act, A.R.S. § 44-3101 et seq.
3. "Respondent" means any person against whom the Division files a complaint, notice, petition, or order.
4. "Securities Act" means the Securities Act of Arizona, A.R.S. § 44-1801 et seq.

R14-4-303. Service

- A. Documents required to be served in an administrative proceeding. All pleadings, motions, appearances, orders, and similar papers filed in the record shall be served upon the Division and each respondent to the administrative proceeding by the filing party. Service shall be made by a person at least 18 years of age.
- B. Service on the Division. Service upon the Division may be made by mailing a copy to the Division addressed to the attorney of record for the Division or by delivering a copy to the Division addressed to the attorney of record for the Division.
- C. Service on a respondent represented by an attorney. Whenever service is required or permitted to be made upon a respondent represented by an attorney, the service shall be made by mailing a copy to the last known business or mailing address of the attorney or by any method authorized under subsections (D) and (E).
- D. Service upon individuals. Service upon an individual may be made by any of the following:
 1. By personal service.
 2. By leaving a copy at the individual's dwelling, or usual place of abode, with an individual of suitable age and discretion residing therein.

3. By leaving a copy at the individual's usual place of business or employment with an employee, express or implied agent, supervisor, owner, officer, partner, or other similar individual of suitable age and discretion.
 4. By leaving a copy with an agent authorized by express or implied appointment or by law to receive service of process for the individual upon whom service is being made.
 5. By mailing a copy to the last known dwelling, usual place of abode, business address, or mailing address. Subpoenas, notices, and temporary cease-and-desist orders served by mail shall be sent, return receipt requested, by certified mail, express mail, registered mail, or commercial courier or delivery service. The signed return receipt shall constitute proof of service, but shall not be the exclusive method of proving service.
- E. Service upon a corporation or other entity. Service upon a corporation, partnership, trust, limited liability company, association, sole proprietorship, or any other entity, may be made by any of the following:
1. By leaving a copy with an employee, of suitable age and discretion, at any place of business of the corporation, partnership, trust, limited liability company, association, sole proprietorship, or other entity.
 2. By leaving a copy with any officer or director of a corporation, managing or general partner of a partnership, trustee of a trust, member of a member-managed limited liability company or manager of a manager-managed limited liability company, or any representative of an association or other entity.
 3. By leaving a copy with any agent authorized by express or implied appointment or by law to receive service of process for the entity upon whom service is being made.
 4. By mailing a copy to the last known business or mailing address. Subpoenas, notices, and temporary cease-and-desist orders served by mail shall be sent, return receipt requested, by certified mail, express mail, registered mail, or commercial courier or delivery service. The signed return receipt shall constitute proof of service, but shall not be the exclusive method of proving service.
- F. Service in a foreign country. When serving a subpoena, notice, or temporary cease-and-desist order in a foreign country, service shall be by any internationally agreed means. If service is not accomplished within 120 calendar days from the date service was undertaken under the internationally agreed means or if no internationally agreed means of service has been established or the international agreement does not prohibit the use of other means of service, then service of any document may be made by any of the following:
1. In the manner prescribed by the law of the foreign country for service in that country in an action in any of its courts of general jurisdiction.

2. As directed by the foreign authority in response to a letter of request.
 3. By any of the following if not prohibited by the law of the foreign country:
 - a. Any method of service authorized by subsections (D) or (E).
 - b. Diplomatic or consular officers when authorized by the United States Department of State.
 - c. By any other lawful method that is reasonably calculated to give notice as directed by the Commission.
- G. When service is complete. Service by mail is complete upon mailing. All other service is complete upon delivery.
- H. Service by Publication.
1. The Division may serve a person by publication under either of the following circumstances:
 - a. The Division does not know the current address or residence of a person to be served.
 - b. The person has avoided service and service by publication is the best means practicable under the circumstances for providing notice of the administrative proceedings.
 2. Service by publication shall be made as follows:
 - a. The Division shall publish a statement regarding the administrative proceedings at least once a week for 4 successive weeks in a newspaper published in Maricopa county. If the person's last known residence or place of business was in a different county in Arizona or another state, the Division shall also simultaneously publish the statement in a newspaper published in the different county. If no newspaper is published in the person's last known county of residence or place of business, then the publications shall be made in a newspaper published in an adjoining county.
 - b. The published statement shall include the following information:
 - i. The name of the person.
 - ii. The statutes or rules that the Division alleges the person has violated or is violating.

- iii. The location and the manner in which the person may obtain a copy of the notice or temporary cease-and-desist order being served.
 - iv. The requirement and deadline for filing a request for hearing and the ability of the Commission to enter a default order if the person fails to timely request a hearing.
3. The service shall be complete 30 days after the first publication.

R14-4-304. Rights of Witnesses; Formal Interview; Procedures

- A. Any person required or requested to appear as a witness at a formal interview may be represented by a lawyer. The lawyer's role during the formal interview shall be limited to the following activities:
1. Giving legal advice to the witness before, during, and after the formal interview.
 2. Questioning the witness briefly at the conclusion of the formal interview for the purpose of clarifying any testimony the witness has given.
 3. Making summary notes during the formal interview solely for the use of the witness and the lawyer.
- B. Notwithstanding subsection (A), the following lawyers may not represent witnesses at a formal interview:
1. Any lawyer who has represented another witness who has testified at a formal interview in the examination or investigation.
 2. Any lawyer who has represented another person who is a subject of the examination or investigation.
 3. Any lawyer who may be a material witness in the examination or investigation.
 4. Any lawyer who is a subject of the examination or investigation.
- C. The Director may permit a lawyer to represent a witness in those situations described in subsections (B)(1) through (B)(4) upon a showing that such representation should be permitted in the interest of justice and will not obstruct the examination or investigation. If a lawyer is not permitted to represent a witness under subsection (B), that lawyer's partners or associates of the lawyer's law firm are also precluded from representing the witness.
- D. All formal interviews may be recorded by the Division either mechanically or by a shorthand reporter employed by the Division. No other recording of the formal interview will be permitted, except summary note taking by the attendees.

- E. In addition to the persons identified in subsections (A), (C), and (D), the following individuals may attend a formal interview:
 - 1. Individuals employed by the Commission or the office of the attorney general.
 - 2. Members of law enforcement or other state, federal, or self-regulatory agencies authorized by the Division.
 - 3. Translators authorized by the Division.
- F. The Division may exclude from a formal interview any person previously permitted to attend the formal interview, including a lawyer, whose conduct is dilatory, obstructionist, or contumacious. In addition, the members of the staff of the Division conducting the formal interview may report the conduct to the Director for appropriate action. The Director may thereupon take such further action as circumstances may warrant, including, but not limited to, exclusion from further participation in the examination or investigation.
- G. A person who has submitted documentary evidence or testimony in connection with a formal interview shall be entitled, upon written request, and upon proper identification, to inspect the witness' own testimony on a date to be set by the Director. The Director may delay the inspection of the record until the conclusion of the examination or investigation if the Director determines that earlier inspection may obstruct or delay the examination or investigation.
- H. In connection with an examination or investigation, the Director may delegate authority to members of the staff to administer oaths and affirmations, sign subpoenas, take evidence, and receive books, papers, contracts, agreements or other documents, records, or information, whether filed or kept in original or copied form or electronically stored or recorded.
- I. During a formal interview, a witness shall not knowingly make any untrue statements of material fact or omit to state any material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading.

R14-4-305. Answers

- A. Within 30 calendar days after the date of service of a notice of an opportunity for a hearing, a respondent who has requested a hearing shall file in the record and serve on the Division an answer to the notice.
- B. The answer shall contain the following:
 - 1. An admission or denial of each allegation in the notice.
 - 2. The original signature of the respondent or the respondent's attorney.

- C. A statement of a lack of sufficient knowledge or information shall be considered a denial of an allegation.
- D. An allegation not denied shall be considered admitted.
- E. When a respondent intends in good faith to deny only a part or a qualification of an allegation, the respondent shall specify that part or qualification of the allegation and shall admit the remainder.
- F. The respondent waives any affirmative defense not raised in the answer.
- G. The officer presiding over the hearing may grant relief from the requirements of this Section for good cause shown.

R14-4-306. Notice of an Opportunity for a Hearing and Notice of a Hearing

- A. The Commission may issue a notice of an opportunity for a hearing or a notice of a hearing to determine whether to issue a cease-and-desist order, order of rescission, restitution, or penalties, or other order authorized pursuant to the provisions of the Securities Act or the IM Act.
- B. A notice of an opportunity for a hearing and a notice of a hearing shall be served by any method permitted in R14-4-303. A notice of an opportunity for a hearing shall set forth that the respondent will be afforded a hearing upon request to docket control of the Commission if the request is made in writing within 10 days after receipt of the notice by the respondent.
- C. When a respondent requests a hearing pursuant to a notice of an opportunity for a hearing in accordance with the provisions of this rule, the Commission shall set a date, time, and place for the hearing and shall forthwith notify the respondent. The date set for the hearing shall be within 60 days, but not earlier than 20 days, after the written request for hearing has been made, unless otherwise provided by law, stipulated by the parties, or ordered by the Commission.

R14-4-307. Temporary Cease-and-desist Orders

- A. When the Commission determines that the public welfare requires immediate action, the Commission may issue a temporary cease-and-desist order, which will be in effect for 180 days or until vacated, modified, or made permanent in accordance with this rule, whichever comes 1st. The Commission may delegate this authority to the Director.
- B. Temporary cease-and-desist orders shall be served pursuant to the provisions of R14-4-303.
- C. The temporary cease-and-desist order shall set forth that the respondent will be afforded a hearing upon request to docket control of the Commission if the request is filed in writing within 20 days of service of the temporary cease-and-desist order. If a request for a hearing

is not filed within 20 days, the Commission may, by written findings of fact and conclusions of law, vacate, modify, or make permanent the temporary cease-and-desist order.

- D. When a respondent requests a hearing in accordance with the provisions of this rule, the Commission shall set a date, time, and place for the hearing and shall forthwith notify the respondent. The date set for the hearing shall be within 30 days, but not earlier than 10 days, after the written request for hearing has been filed, unless otherwise provided by law, stipulated by the parties, or ordered by the Commission. The Commission may, after such hearing, by written findings of fact and conclusions of law, vacate, modify, or make permanent the temporary cease-and-desist order.
- E. The effective date stated in subsection (A) shall be tolled from the date a hearing is requested until a decision is entered, unless otherwise ordered by the Commission.

R14-4-308. Rescission and Restitution

- A. When a person or persons have violated the Securities Act or the IM Act, or any rule or order of the Commission, the Commission may require the person or persons to make rescission and/or restitution as provided herein.
- B. If a rescission offer is ordered by the Commission,
 - 1. The respondent shall submit the following materials to the Division and, upon approval from the Director, distribute the materials to the purchasers:
 - a. A written offer to repurchase stating in reasonable detail the facts out of which liability arose and, in the event of a violation of A.R.S. §§ 44-1991, 44-1992, or 44-3241, the correct, true, or omitted facts. An offer to repurchase the security shall include an offer of:
 - i. Cash equal to the fair market value of the consideration paid, determined as of the date such payment was originally paid by the buyer; together with
 - ii. Interest at a rate pursuant to A.R.S. § 44-1201 for the period from the date of the purchase payment to the date of repayment; less
 - iii. The amount of any principal, interest, or other distributions received on the security for the period from the date of purchase payment to the date of repayment.
 - b. The offer to repurchase shall be accompanied by a prospectus and other documents making full written disclosure about the financial and business condition of the issuer and the financial and business risks associated with the retention of the securities.

- c. The offer to repurchase shall state that such offer may be accepted by the purchaser at any time within a specified period of not less than 30 days after the date of receipt thereof.
2. The offer and any other materials required to be presented to the purchaser shall be made within a period specified by the Commission.
3. Financial statements prepared in accordance with R14-4-120, A.R.S. § 44-3159, or other documents relating to the business of the respondent as requested by the Director or the Commission, shall be provided to the Director. If a respondent demonstrates that it cannot obtain audited financial statements without unreasonable effort or expense, then the respondent shall provide to the Director a notarized statement of financial condition. The financial statements or documentation shall demonstrate that the person or persons funding the rescission offer has or have adequate funds to pay the amount ordered pursuant to subsection (B)(1)(a) to all purchasers of the securities who are eligible to accept the rescission offer. The seller, issuer, or other 3rd party may fund the rescission offer.
4. The Commission may order that funds be deposited in escrow.
5. When the rescission offer has been completed and the appropriate funds paid, the person funding the rescission offer shall verify to the Director that the rescission offer was made in accordance with this rule. The verification may be performed by an independent 3rd party, such as an accountant or escrow agent, by providing the pertinent records documenting the rescission offer to the Director. All of the following information must be included:
 - a. Names, addresses, and telephone numbers of all securities holders of the issuer who had a right to receive the rescission offer, the amount and purchase dates of securities held by such securities holders, and the amount of principal, interest, or other distributions on all securities held by such securities holders.
 - b. Names, addresses, and telephone numbers of all securities holders of the issuer who did not receive the rescission offer and the reason why they did not receive the rescission offer, the amount and purchase dates of securities held by such securities holders, and the amount of principal, interest, or other distributions on all securities held by such securities holders.
 - c. Verification of receipt of the rescission offer by all securities holders who had a right to and did receive the rescission offer.
 - d. A list of securities holders who accepted the rescission offer and those who did not accept.

- e. Verification of payment of principal and interest ordered to be paid to all such securities holders who accepted the rescission offer.
- 6. Based on the circumstances of the respondent and the purchasers, if necessary or appropriate to the public interest and consistent with the protection of the investors, the Commission may prescribe by order alternative rescission offer terms, including:
 - i. The offer of other identified assets in lieu of cash if the respondent lacks sufficient cash to offer the amount required under subsection (B)(1)(a).
 - ii. The offer of a specified lesser amount than the amount required under subsection (B)(1)(a) if the respondent lacks sufficient assets to offer the amount required under subsection (B)(1)(a).
 - iii. The inclusion in the repurchase offer of information material to an understanding of the issuer, in addition to that required by subsection (B)(1)(b), if such information would be required if the securities were being registered.
 - iv. A shorter period of time during which the offer to repurchase may be accepted.
 - v. Waiver of specified information required by subsection (B)(5) if the Commission determines that producing such information will be unduly burdensome.

C. If restitution is ordered by the Commission,

- 1. The amount payable as damages to each purchaser shall include:
 - a. Cash equal to the fair market value of the consideration paid, determined as of the date such payment was originally paid by the buyer; together with
 - b. Interest at a rate pursuant to A.R.S. § 44-1201 for the period from the date of the purchase payment to the date of repayment; less
 - c. The amount of any principal, interest, or other distributions received on the security for the period from the date of purchase payment to the date of repayment.
- 2. Financial statements prepared in accordance with R14-4-120, A.R.S. § 44-3159, or other documents relating to the business of the respondent as requested by the Director or the Commission, shall be provided to the Director. If a respondent demonstrates that it cannot obtain audited financial statements without unreasonable effort or expense, then the respondent shall provide to the Director a notarized statement of financial condition. The financial statements or documentation shall demonstrate that the person paying restitution has adequate funds to pay all purchasers the amount computed in subsection (C)(1).

3. The Commission may order that funds be deposited in escrow.
4. The Commission may order the respondent to provide the following information to the Division:
 - a. Names, addresses, and telephone numbers of all securities purchasers who had a right to receive restitution under the Commission's order; amount and purchase dates of securities purchased by such purchasers; fair market value of any non-cash consideration received by respondent from each purchaser of such securities; and any payment of principal, interest, or any other distribution on such security.
 - b. Verification of payment of principal and interest ordered to be paid to all such purchasers.
5. Based on the circumstances of the respondent and the purchasers, if necessary or appropriate to the public interest and consistent with the protection of the investors, the Commission may prescribe by order alternative restitution terms, including:
 - i. The payment of other identified assets in lieu of cash if the respondent lacks sufficient cash to pay the amount required under subsection (C)(1).
 - ii. The payment of a specified lesser amount than required under subsection (C)(1) if the respondent lacks sufficient assets to meet the subsection (C)(1) requirement.

BEFORE THE ARIZONA CORPORATION COMMISSION

WILLIAM A. MUNDELL

Chairman

JIM IRVIN

Commissioner

MARC SPITZER

Commissioner

In the matter of

PROPOSED RULEMAKING REGARDING
TITLE 14, CHAPTER 4, ARTICLE 3, OF THE
ARIZONA ADMINISTRATIVE CODE

DOCKET NO. RS-00000A-00-0752

DECISION NO. _____

ORDER

Open Meeting

August 28-29, 2001

Phoenix, AZ

BY THE COMMISSION:

INTRODUCTION

The Securities Division (the "Division") of the Arizona Corporation Commission (the "Commission") has forwarded to the Commission a proposal recommending that the Commission repeal A.A.C. R14-4-301 through R14-4-308 and make R14-4-301 through R14-4-308 ("Article 3") governing the administration of the securities statutes.

FINDINGS

1. Article 3 governs the conduct of administrative actions under the Arizona Securities Act and the Arizona Investment Management Act.

2. The Division has recommended that Article 3 be changed to reflect recent statutory changes and to facilitate the administrative process.

3. The Division has recommended that a notice of the proposed rulemaking regarding Article 3 be forwarded to the secretary of state. The Division also has recommended that the Hearing Division schedule a hearing to receive public comment on Article 3 no sooner than November 5, 2001.

4. The Commission finds that the Division's recommendations have merit and that the proposed Article 3 should be published and public comment obtained.

CONCLUSION OF LAW

The Commission has the authority for the proposed rulemaking under the Arizona Constitution Article XV §§ 4, 6, and 13, and under A.R.S. §§ 44-1821, 44-1972, 44-1973, and 44-2032.

ORDER

THEREFORE IT IS ORDERED that a hearing be set by the Hearing Division on this matter at the Commission Offices in Phoenix, Arizona, no earlier than November 5, 2001.

IT IS FURTHER ORDERED that the Division prepare a notice of the proposed rulemaking and forward it to the office of the secretary of state for publication in the Arizona Administrative Register.

IT IS FURTHER ORDERED that this Decision shall become effective immediately.

BY ORDER OF THE ARIZONA CORPORATION COMMISSION

CHAIRMAN

COMMISSIONER

COMMISSIONER

IN WITNESS WHEREOF, I, BRIAN C. MCNEIL, Executive Secretary of the Arizona Corporation Commission, have hereunto set my hand and caused the official seal of the Commission to be affixed at the Capitol, in the City of Phoenix, this _____ day of _____, 2001.

BRIAN C. MCNEIL
Executive Secretary

DISSENT
ctf

This document is available in alternative formats by contacting Shelly M. Hood, ADA Coordinator, voice phone number 602-542-3931, E-mail shood@cc.state.az.us.